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Economic Conditions
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General Business Conditions

THE economic situation in this country has shown during recent weeks three significant and related changes. One is a growing number of cutbacks in the war production program. The second is the disclosure that supplies of a good many basic materials are now outrunning war needs. The third is a reduction in the Treasury deficit, and hence in the rate of increase in inflationary pressures, as compared with earlier estimates.

For a long time all changes in the industrial organization were in one direction. They were designed wholly to expand supplies of materials and manpower, and to concentrate both on the job of increasing war production. They have succeeded beyond anything ever known in industrial history, for munitions production increased six and a half times between November 1941 and October of this year, and the industries are turning out war materials and equipment at the rate, according to latest War Production Board statements, of $75 billions annually, a figure which is not far short of the total national product before the war.

It now seems likely that this gigantic effort, in the aggregate, has reached its approximate climax. Although needs for war materials are still expanding in some items and are still unsatisfied in many, they are declining in others. Cancellation of war orders is not new, for it began a year ago. By the end of October the Army had cancelled over 12,000 prime contracts representing nearly $8 billions. Most of the early cancellations reflected either changes in design to embody improvements, or modifications of tactics and strategy; and changes of this kind go on continuously. Many of the recent cutbacks, however, also represent reductions in estimates of requirements, due to accumulation of stocks and to restudy of the program. They apply chiefly to small arms ammunition and other ordnance items, some of the metals, ground troops' equipment and anti-submarine vessels.

These cuts have been made in response to a variety of changed conditions, including the filling up of the "pipelines" reaching from producers in this country to supply dumps abroad, the great reduction in losses of ships and supplies through U-boat action, the shortening of ship routes through the re-opening of the Mediterranean, the elimination of Italy and especially the Italian navy from the ranks of the enemy, and finally the approaching end of Army expansion. Also they reflect the evident fact that even while the military effort is being accelerated the requirements for particular kinds of military goods, as measured against the productive capacity of this country, eventually reach their limits. They reflect scrutiny of the program for the purpose of eliminating waste and avoiding accumulation of excessive stock piles. Every reduction that is made through such scrutiny makes possible a greater concentration on the things most needed and diminishes the magnitude of the inflationary danger.

The completion of war plants reduces construction and equipment expenditures. Machine tool shipments in October were more than 40 per cent below last December's peak and public construction contracts awarded in the same month were 78 per cent below a year ago.

Army "Savings"

Representative Snyder, chairman of the House Military Appropriations subcommittee, told Congress during the month that some $13 billions of War Department appropriations for this fiscal year would not be spent, but would revert to the Treasury. The prospective "savings" comprise: (1) $1,946 millions from a reduction of 548,000 in military personnel previously estimated at 8,200,000; (2) $8,263 millions from curtailment of the armament and equipment program; (3) $780 millions from reduction in facilities and maintenance; (4) $2,086 millions from modification and possible deferment of part of the airplane program; (5) $88 millions from miscellaneous projects.

It should be understood that this "saving" —which consists of not making expenditures that had been authorized — does not signify

that current estimates of Army costs in the fiscal year can forthwith be reduced by $13 billions, for budget estimates and appropriations are two different categories. Total appropriations available in the fiscal year include large unexpended balances carried forward from preceding years, and include also appropriations for various expenditures likely to carry over in part to later years. Budget figures, on the other hand, are estimates of the actual funds needed by the Treasury to meet expenditures. In the case of the Navy, Budget Director Smith points out that while some 1943-44 appropriations will be unexpended, other appropriations of equivalent amount, principally for landing craft, are being asked for.

The significance of the program reduction, however, is apparent. It means, ultimately, so much less money to be raised and spent, and so much less call for manpower and materials for war.

Raw Materials Position Easier

A second and in part a related development is the easing in the position of some industrial materials and even a few foodstuffs. Evidence of more abundant supplies of most metals has been placed on record by War Production Board orders and announcements.

The production of virgin aluminum has been exceeding needs and scrap aluminum has piled up to glut the market. Contracts for building three large aluminum fabrication plants have been cancelled. W.P.B. has now listed zinc, aluminum, magnesium and the ferro-alloys as sufficient for all war and essential civilian needs, joining lead in that category, and copper is expected to be added to it soon. Restrictions on the use of these metals have been lightened in some directions. Rolling of brass for war use is expected to be curtailed, beginning in January. There are many indications that the steel supply situation is easing somewhat. Mercury and antimony are available for non-essential civilian use, and imports are being cut back sharply. The broad policy is to discourage further extension of high-cost metal production, which commands premium prices, and to stop extending foreign purchases.

All this is in contrast to the situation a year and a half or two years ago, when every day brought its quota of expanding appropriations for war and its new orders limiting the use of materials for civilian goods. It would be wrong to suggest that conditions have traversed the full circle, or any substantial part of it, for manifestly war production in the aggregate must continue to call on the country's resources to an extent which will restrict civilian production drastically until at least one of the two wars ends. The first effect of cutting back war procurement in some directions is to permit a greater concentration of effort in others,—on airplanes and amphibious equipment, signal equipment, and other products; and that is where the labor released by the cutbacks should go. However, the prospect for increasing output of certain needed civilian goods—needed to maintain productive efficiency— is also improved.

Mr. Whiteside, head of the Office of Civilian Requirements, has a program for the manufacture of 2,000,000 electric irons and substantial quantities of electric refrigerators, washing machines and portable lamps. He says that aluminum kitchenware will soon make its reappearance, and that copper wire for lighting equipment will be available. This is in addition to larger quotas already announced for railway equipment, farm equipment, motor trucks and food processing machinery. Motor truck manufacturers, who have had one increase in the quota for civilian trucks, expect another. These promises are backed by expectations that more steel will be allotted, but manufacturers will be able to increase their production only to the extent that they can get the necessary labor and supplies of bearings, small motors, and other essential parts.

Business Sentiment Influenced

Business sentiment is naturally influenced by these developments. At the same time, the news from the battlefronts has been favorable, with further great defeats for the German armies in Russia and renewed destructive bombing of German cities. It is reasonable to believe that the Moscow agreements, apart from their high promise for the post-war world, may help shorten the European war, for they must destroy German hope of dividing the United Nations, which is one of the reasons Germany has kept on fighting.

Thus the war news keeps alive the sense that "anything can happen." Without counting upon an early German collapse, and without lagging in all-out production of everything the military forces need, as long as may be required, business men nevertheless are looking more and more both toward the end of the war and toward changes in the war program that may come before its end.

Some of the speculative markets, including stocks and a few commodities, have reacted during the month. The fact that the decline was accompanied by rumors of negotiations for German surrender may be accepted as significant, even though it is uncertain whether the rumors caused the market action or the market action caused the rumors. The truth of the matter, however, seems to be that most people find it hard to decide whether they should fear post-war inflation or post-war deflation more. Economists and business advisors without number can be found to support either view, and most business men hardly

know what to think. Meanwhile they, more than any other group, can appreciate the difficulties of reconverting the economic organization to peacetime work, and the gravity of the problems which confront industry and government. It is understandable that the first reaction to the approach of the end of the European war and to reconversion is to avoid unnecessary commitments and wait for a clearer view. In the industries particularly, and possibly to some degree in trade, this creates caution against excess inventory accumulations.

The appointment of Mr. Baruch as the chief policy maker for the reconversion of the economy from war to peace has been heralded on all sides. The prestige that Mr. Baruch commands is derived not only from his experience in the last war but from the success that he and his associates have had in clearing up confusion in the synthetic rubber program and in dealing with the manpower problem on the Pacific coast. Mr. Baruch is a man who asks for adequate powers when he accepts responsibility, and he is in position to make a contribution of inestimable value to the solution of such problems as contract termination, inventory disposal, disposition of government plants and surpluses, and demobilization of armed forces and war plant personnel. The study of these problems is now unfortunately complicated by dispersion of authority and responsibility. This results in confusion and disagreement among agencies which are actually putting policy into practice, and also in a disturbing amount of jockeying for power and position which is an obstacle to getting policies established and organizations prepared for smooth operation.

It can hardly be over-emphasized that whether business will move from war to postwar conditions with a minimum or maximum amount of disruption is not fore-ordained. It will depend upon policies established and followed now, both by industry and government.

The Inflation Problem

The third change in the economic situation, of those listed at the beginning of this discussion, is that the building up of inflationary pressures, through expansion of bank credit to finance the Treasury deficit, is no longer at an accelerating rate. Experienced observers agree (1) that the deficit is shrinking; (2) that the Treasury can now finance its requirements, for a considerable time at least and perhaps indefinitely if the European war should end by next summer, without selling new securities directly to commercial banks.

The program for the Fourth War Loan, announced during November and described more fully on a later page, recognizes the feasibility of covering the deficit by borrowing from nonbanking investors. Except for limited amounts designed to afford investments for the savings deposits which commercial banks are receiving, the Loan will include no offering to these banks; and — on the reasonable assumption that the Loan will be successful—any further expansion of bank credit which results from the Treasury's needs will be confined to purchases by banks in the market. These, obviously, will be much smaller than the additions banks have made to their holdings in the past year and a half.

This is a noteworthy change. Its importance is that the quantity of deposit-money—created by the extension of bank credit to the Treasury and the subsequent disbursement of the funds by the Treasury to corporations and individuals —will no longer rise at the former rate. It marks great progress toward covering the deficit, as it should be covered, out of the money that people and business earn and save.

It does not signify, however, that the inflationary danger is at an end or that vigilance can be relaxed. In the first place, people must continue to save and buy War Bonds at the necessary rate. Second, even if bank deposits should expand no more, the fact remains that they have more than doubled since 1939, and that the volume of currency in circulation has increased 170 per cent. This is enough to feed an inflationary conflagration, if people should suddenly decide to spend their money wildly.

The fact is, of course, that the inflation problem is not only a problem of excess money; it is a problem of what people do with the money, and essentially whether they save, invest and pay off debt rather than rush to spend it all. Obviously there is too much "bad spending," and not everyone exercises financial common sense, but the present situation supplies evidence that the substantial majority of people are handling their money with economy and restraint.

Problems of Wage and Price Stability

The most disturbing development of the month has been the emergence of new dangers to price and wage stability. Since early this year price indexes have been encouragingly steady. The average of wholesale prices, as measured by the Bureau of Labor Statistics, has held within a range of two percentage points (102 to 104, on the basis of 1926=100) since the beginning of February. Prices of basic raw materials and crude foodstuffs have moved sideways on the average since about March. The cost of living, according to the official index, rose through May, declined slightly during the summer, and rose again in September and October. In October it was still below the May peak, standing at 124.4 on the basis of 1935-39 = 100.

Many people question the accuracy of the official cost of living figures, on the ground

that personal experience indicates a greater rise than the index shows. It is doubtless true that the index does not fully reflect deterioration in quality of goods, nor the fact that where accustomed goods or services are no longer available substitutes are often higher priced. Nor can it cover all cases of "black markets" or violation of price ceilings. Some allowance should be made for these factors. However, the belief that the official figures are simply an index of price ceilings, rather than prices actually paid, is erroneous, for the investigators gather quotations directly at retail store counters. The index was "modernized" last Spring, and at the invitation of the Department of Labor its preparation was reviewed by a committee of experts appointed by the American Statistical Association. These experts found it a "trustworthy measure" of cost of living changes for people of moderate incomes in large cities, although emphasizing the limitations of a figure which is a national average covering only large cities.

Present demands for higher wages are based on the fact that the cost of living index has advanced 5.6 per cent since passage of the Stabilization Act of October 2, 1942, on the assertion that wage rates have not advanced commensurately and should be so advanced, and on the further assertion that the index is not representative. The President has directed the War Labor Board to make a re-examination of the cost of living, and this will delay major wage decisions until the study is completed, around the first of the year.

The Wage Arguments

Wage questions are difficult to deal with because feelings are easily aroused, opinions are strongly held, and the facts are many-sided and susceptible of varying interpretation. In no field of debate are the limitations of statistical evidence, or perhaps more accurately the human tendency to select and arrange statistics primarily for the purpose of proving a case, more apparent; and the result is to spread confusion and obscure principles. The arguments of the unions are largely based on considerations of equity, that is, on representations that workers in general are at a disadvantage relative to other groups, or relative to some past period. These considerations are important. However, it is probably correct to say that public opinion — aware of the increases of 87 per cent in average weekly wages per factory worker, and of 59 per cent in average hourly wages, since September, 1939—does not find convincing the comparisons usually offered to show workers at a disadvantage. Thus the American Federation of Labor, in its November Monthly Survey, compares workers' hourly wage rates (average hourly earnings adjusted to eliminate effect of shifts from lower-paid to higher-paid jobs), up 6 per cent from October, 1942 to August, 1943, with farm prices, up 13 per cent, and corporation profits, up 13 per cent.

All such comparisons involve choice of a base period; the farmers, if they desire to show that the inequities are on their side, can select a base period which would yield different results. In many respects the things compared are not comparable. Rates of wages and corporate earnings are unlike things. One is a rate, the other an aggregate. Since corporation earnings can drop to nothing, or less than nothing, the percentage range in their fluctuations is necessarily greater. Comparisons of percentage changes in the two things are therefore meaningless. Moreover, it is hard to determine what real corporate earnings are, since it is uncertain what future costs and losses, properly chargeable against the receipts of this period, will be. Dividends received by stockholders in general are down, not up. Wages paid, on the other hand, are money in the pocket. It would be more logical to compare the total wage payments, up 19 per cent since October, 1942, with corporation earnings, up 13 per cent, which gives a different result.

What Is the Wage Rate?

Average hourly earnings received by manufacturing workers have risen more than the cost of living in any representative period that may be selected since the war started. Since October 2, 1942, through September 15, 1943, this average as reported by the Bureau of Labor Statistics, had advanced 11.3 per cent, compared with the cost of living increase of 5.2 per cent. The unions maintain, however, that the average hourly earning is not the material consideration. They point out that it is raised by premiums for overtime, by differentials for night shifts, by upgrading of workers within plants, by shifts from low wage to high wage industries, and by greater productivity of workers on incentive payment plans. Hence the statement that the B.L.S. figures are not representative of basic straight-time wage rates, which is accompanied by the claim that basic rates, controlled by War Labor Board decisions, have not kept pace with the cost of living. This is the argument for breaking the Little Steel formula.

Representations that there are differences between basic rates and average hourly earnings are manifestly correct. The question is as to the significance of the differences. Clearly it is hourly earnings which constitute the money cost of labor to the manufacturer. The premium that the manufacturer pays for overtime is an extra cost, and so is the night shift differential. A simple calculation shows that time and a half for eight hours in a forty-eight hour week adds 8 1/3 per cent to the

labor cost of each unit of output during the week. This is enough to prevent overtime work in certain industries, and so to cut the national production.

To be sure, if other costs can be reduced by overtime and night work to offset the increased labor cost, the total cost per unit of product may not be raised and frequently is cut; this justifies the night shift differential, in particular. As to upgrading, or promotion, it does not raise the cost of labor if it is genuinely based on increases in skill and productivity, but it is common testimony that under conditions now prevailing much upgrading is fictitious, or at least much more rapid than formerly.

However the responsibility may be distributed, such rough indexes as are available suggest that although production per worker has increased immensely during the war, the production per dollar of factory payroll has declined and the labor cost per unit of product has increased. According to the Federal Reserve Board's index, production in the manufacturing industries as of September, 1943, was 145 per cent greater than the 1939 average. The rise in factory employment, according to the Reserve Board's index based on B.L.S. figures, was 70 per cent. The increase in factory payrolls was 228 per cent. From these figures can be derived indexes of production per employe, up 44 per cent; production per dollar of payroll, down 25 per cent; and wages per unit of output, up 34 per cent.

Pressure to Lift Prices

If increases in basic wage rates should now spread generally through the industries a further rise in the labor cost per unit of production would have to be expected. Additional pressure to lift prices would be generated. If the industries should absorb the higher wages without raising prices, their taxable income would be reduced and much of the cost of the wage increase would therefore fall on the Treasury. The increase in taxes received from the increased workers' income could not compensate, since workers are taxed at lower rates. Also, the "take home" pay would be increased further, widening the inflationary gap between incomes at the disposal of individuals and the value of consumers' goods and services produced.

Finally, the public interest is concerned not only with inflationary dangers during the war but the situation that will exist after the war. The practical reason for the unions' emphasis on the basic straight time rate as the measure of the price of labor is to be found in the fact that the basic rate, established by collective bargaining, will last as long as the bargaining agreement lasts, while overtime premiums, shift differentials, abnormal upgrading, and shifts into higher-paying plants may disappear, in varying degree. Labor leaders foresee a drop in weekly wages after the war. They seek to prepare against it by obtaining further increases in basic straight time rates, in addition to those it has already obtained under the Little Steel formula.

The question is, can the industries stand such an increase in costs in the post-war situation, and still be able to set prices that will sell their goods and enable them to give employment? Will farmers, non-manufacturing labor, white collar workers, pensioners and other people who are not in the labor force, be able to pay for the products of such high-wage labor? Will foreigners be able to buy American goods?

The misfortune of inflation is not only that it gets the economic situation up on stilts, but that it creates distortions in cost, price and wage relationships. These distortions may not seem important during the war, for the Government is the great customer of the industries and government purchases keep trade going. For the post-war period, however, they present sobering questions.

The Improved Budget Outlook

The large reduction from previous estimates in the indicated government deficit for the current fiscal year, as shown by announcements last month that large appropriations for the Army and Navy would not be used, and by revised estimates issued by the Treasury and the Budget Bureau, had been clearly foreshadowed by the favorable trend of actual receipts and expenditures during recent months.

Budget Director Harold D. Smith stated on November 27 that the estimated total of expenditures for war activities during the current fiscal year had been reduced from $100 billions to $92 billions. These totals apparently include the RFC expenditures for war activities handled outside of the budget and estimated at $3 billions; thus, for the budget totals alone, there would be a reduction from $97 billions to $89 billions. The change would reduce total expenditures (including $3 billions for interest and $4 billions for other activities) from the $104 billions estimated in the budget to $96 billions.

Mr. Smith pointed out that war expenditures, including the agencies, from July through October ran at an annual rate of $87 billions, but in November rose to substantially above the $90 billions level; and he expressed the opinion that expenditures were likely to increase still further as aircraft production and shipbuilding are further expanded. Whether this anticipated increase will actually occur remains to be seen, as there is the possibility that cutbacks and cancellations of contracts, in connection with readjustments in the

war program, may again affect the estimates, as they have done in recent months. Moreover, an early ending of the war naturally would change the entire picture.

On the receipts side, the current figures reported by the Treasury also reveal a trend considerably more favorable than the previous budget estimates. Although the course of monthly receipts is highly uneven, because of the quarterly payments of corporation income taxes and social security taxes, the changeover of personal income taxes to a current payment basis, and irregular receipts of other items of revenue, the steep increases over last year may be seen from the following summary by principal sources and by months:

U. S. Treasury Receipts, July 1 to Nov. 25
(In Millions of Dollars)

By Principal Sources	1942	1943	% Change
Income tax—withheld	$	$2,773	+......
Income tax—other	2,948	7,436	+152
Misc. internal revenue	1,718	2,394	+ 39
Social security taxes	620	745	+ 20
Customs	112	171	+ 53
Misc. receipts	120	1,243	+936
Total receipts	$5.517	$14,761	+168
Less—social sec. tr. fds.	530	637	+ 20
Total net receipts	$4,988	$14,125	+183
Net Receipts By Months			
July	$ 747	$2,007	+169
August	587	2,721	+364
September	2,527	5,447	+116
October	607	2,030	+234
November 1-25	520	1,919	+269
Total net receipts	$4,988	$14,125	+183

It will be seen that net receipts for the first (July - September) quarter of the fiscal year were at an annual rate of more than $40 billions. Also, as pointed out in our discussion of this question in the Bank Letter last month, it seems probable that the revenue gains for the first quarter understate rather than overstate the productiveness of present taxes, since (1) the national income on which taxes apply is still rising; (2) the 12½ per cent personal income tax carryover payable next March should more than offset any refunds due; (3) the first monthly withholding tax collections were in August.

Recognizing these trends, the Treasury has revised upward its estimate of the yield from existing tax laws to $41,137 millions. This would compare with $38,148 millions given in the revised (July) budget and with $33,081 millions in the original (January) budget. It would contrast with actual net receipts in earlier fiscal years as follows:

(In Millions of Dollars)

1944 (estimated)	$41,137	1932 (Post-war low)	$2,006
1943	22,282	1920 (World War I peak)	6,995
1942	12,799	1914 (Pre-war)	735
1941	7,607		
1940	5,387		
1939	5,165		

The combination of $3 billions increased receipts and $8 billions decreased expenditures results in a reduction in the estimated net deficit (exclusive of agencies) from $66 to $55 billions, while the public debt on June 30, 1944 is now placed at $194 billions, as compared with the earlier forecasts of $206 billions made last July and $211 billions last January.

The Sum-Total of Federal Taxes

Even the more than $41 billions in "total net receipts" now estimated for the current fiscal year does not measure the sum-total of federal taxes. First, it does not include the social security tax collections of over $3 billions, handled as trust fund receipts rather than revenue receipts, and invested in special issues of government securities, thus helping to finance (but not reduce) the budget deficit. Secondly, it makes no allowance for the yield from the proposed new taxes, estimated at $2,140 millions on an annual basis. Senator George, chairman of the Senate Finance Committee, is quoted as saying that the new bill would raise annual federal levies of all kinds to a total of about $45 billions.

This would mean total tax collections (including social security taxes) at an annual rate about 47 per cent of total expenditures, which compares favorably with other countries, whose records heretofore have been held up as showing how much more the United States could do toward increasing taxes and holding down the sale of government securities to the banks. Although the budgets of different countries are not strictly comparable, it is interesting to note that the 1944 budget of Great Britain shows total taxes at 50.5 per cent of total expenditures, while that of Canada for 1944 shows taxes at 46.8 per cent. These figures do not include state and local government taxes and expenditures, which are much heavier here.

The tax policy in this country should not, of course, be based upon what other countries are doing. The real question is whether *we* are doing all we can in the way of taxing without placing unwarranted and injurious burdens upon people and upon industry. Reports of lavish expenditures for many luxury goods and amusements indicate that there are many people with "money to burn" despite current taxes and war bond drives. While it would be impossible to reach this class of spenders through income taxes without ruinous pressure upon great numbers of people who are having to budget their incomes and expenses more carefully, there is a powerful argument for raising more money through consumption taxes, judiciously graduated and with proper exemptions for necessities. In this way people who have money to spend for nonessentials, and especially those who feel they can afford to indulge in extravagances, would

be taxed accordingly, while people who have little or no surplus income over necessities, or who wish to save their money, would not be taxed. At a time when income taxes have already been carried to such extremes and so rapidly, this is the only taxation "in accordance with capacity to pay" that makes sense.

The Fourth War Loan

The reduced deficit now indicated for the current fiscal year is reflected in the size and terms of the Fourth War Loan, announced last month to extend from January 18 to February 15. The goal is set at $14 billions, and is to be limited, as was the preceding loan, to individuals and to institutional investors other than the commercial banks, except that the latter may purchase limited amounts of the bonds for the investment of their time deposits. The goal for the new loan compares with $15 billions asked and $18.9 billions actually subscribed in the Third War Loan, with $13.5 billions subscribed in the Second War Loan, and with $7.9 billions subscribed in the First War Loan. In addition, there were commercial bank subscriptions following the third loan drive of $3.2 billions, while in each of the first two drives the commercial banks were permitted to subscribe to a total of $5 billions.

The issues to be offered will be the same as in the last loan, namely, Series E, F, and G savings bonds, tax saving notes, one-year 7/8 per cent certificates and 21/26-year 2½ per cent bonds, but in place of the 10-year 2 per cent bonds there will be offered an issue of 13/16-year 2¼s.

The increasing efforts during previous drives to broaden the individual subscriptions will receive even greater emphasis during the fourth drive. The quota for such subscriptions has been set at $5.5 billions, compared with a goal of $5 billions and actual subscriptions of $5,377 millions in the third drive.

During the first two weeks of the drive, only sales to individuals will be reported, thus focusing attention upon this part of the program, and avoiding the publicity given to large institutional purchases which might be discouraging to the small investor. All subscriptions for savings bonds and savings notes received at Federal Reserve Banks from January 1 to February 29 will be credited to the drive.

War Savings Bonds

Sales of war savings bonds during the third drive totaled $3,300 millions, against $2,140 millions in the second drive and $1,000 millions in the first. Of the total in the third drive, sales of Series E savings bonds amounted to $2,472 millions, and although failing to reach the quota, nevertheless were 68 per cent or $1 billion higher than sales in the second drive.

Following the heavy purchases during the drive, sales (of all series) fell during the first 26 days of November to a rate of about $740 millions for the full month, which is less than half that of the level reached in September and October during the drive. Redemptions during the same period of November were at the rate of about $170 millions for the full month. While this is the highest monthly redemption yet reported and represented a ratio of 23 per cent to sales, it must be borne in mind that as the aggregate of bonds outstanding increases, the ratio of redemptions to current sales will naturally increase also. As compared with the total of over $26 billions of war savings bonds (including the old "baby" bonds) outstanding on November 1, the monthly redemptions were but slightly above ½ of one per cent, compared with about 1/3 of one per cent on $13 billions outstanding in November 1942. The trend during the past two years is shown below:

Percentage of War Savings Bond Redemptions to Total Amounts Outstanding

Month	1942	1943
January	0.24	0.42
February	0.22	0.47
March	0.28	0.77
April	0.25	0.58
May	0.25	0.54
June	0.24	0.69
July	0.25	0.65
August	0.29	0.69
September	0.29	0.68
October	0.32	0.59
November	0.32	0.58*
December	0.39	

* Estimate based upon first 26 days.

It will be seen that the ratios have run higher this year than last, but that November was considerably below many other months this year. The higher ratios this year undoubtedly reflect the heavier selling pressure in connection with the bond drives and the regular payroll deduction purchases, combined with rising taxes and living costs. In view of these facts, the record is excellent.

"We Owe It to Ourselves"

The rapid rise of the national debt and increase of taxes are causing people to think more and more beyond the immediate problem of combating the inflationary effects of government spending, to the post-war problem of carrying a greatly expanded public debt. Recently Secretary Morgenthau, on his return from a tour of the Mediterranean battle area, reported that he found soldiers worried over the growing debt and fearful that "they'll have to fight the war and pay for it too." Treasury officials, in presenting their tax program to the Ways and Means Committee in October, took cognizance of the post-war debt problem and stressed its importance, as follows:

> After the war, heavy interest charges will be a handicap in reshaping the federal budget. During the years when the country is working off the wartime backlog of unsatisfied consumer and business demand,

the federal government may well need to have a surplus rather than a deficit, if post-war inflation is to be avoided. But in the face of heavy interest charges, a surplus could be obtained only by continuing wartime tax rates for years or by neglecting urgent expenditures for public works, public health, and education. The way to keep this problem within manageable bounds is to act now to check the rise of debt.

Statements of a similar point of view regarding debt—often in much stronger terms—could be cited from many other sources. We hear on every side expressions of concern by business men, investors, and even by great numbers of plain people not ordinarily interested in public finance as to where the growth of debt is taking us. People are being influenced in their habits of saving and spending by their apprehensions on this question.

At the same time that so many people share these anxieties, we are told by a new school of economists that the fears of rising government debt are greatly exaggerated. There is nothing, they say, essentially dangerous about a big national debt; in fact, it may even prove a blessing.

A New Doctrine of Public Debt

One of the arguments most commonly advanced in support of this view is that a public debt, internally held, is no real burden, since we only "owe it to ourselves."

This argument is constantly cropping up in discussions of the debt, and has been advanced on high authority as an important mitigating circumstance. Thus, in a letter to Senator Byrd of Virginia in December 1938 in defense of the federal spending policy, Chairman Eccles of the Federal Reserve Board asks, "Is it of no significance that as a nation we owe our debts to ourselves and not to a foreign country?" On another occasion Mr. Eccles enlarged on this point as follows: "The burden of interest that we speak about is not of itself a burden if the debt is held within our own economy, because the interest which is paid also goes back to the economy as a whole, increases income, and therefore increases our ability to pay taxes." In May 1939 the President, in a public address, appeared to voice this same philosophy when he said:

> And when this week you see all the crocodile tears about the burden of our grandchildren to pay the government debt, remember this: our national debt, after all, is an internal debt, owed not only by the nation but to the nation. If our children have to pay the interest on it, they will pay that interest to themselves.

Professor Alvin Hansen of Harvard University, whose writings in collaboration with Guy Greer in Harper's and Fortune magazines on the subject of government debt and fiscal policy have attracted widespread popular attention, asserts that "a government debt *internally held* (italics his) is so completely different from an ordinary personal or business debt that it could hardly be called a debt at all."

This statement is likely to startle most persons brought up on orthodox ideas of finance; and certainly the theories propounded in the above quotations need careful examination. Their espousal by serious scholars and high government officials has influenced public thinking and played a large part in shaping public policy as to the debt in recent years, and may do so again in the future.

If these doctrines are valid and an internal debt is no burden, or even "hardly a debt at all", then apparently the soldiers Mr. Morgenthau spoke about can quit worrying about who is going to pay for the war, and the Treasury officials who appeared before Congress are needlessly concerned about post-war interest charges and keeping the debt within "manageable bounds." Carried to its logical conclusion, what the argument seems to add up to is that it makes no difference how high the debt goes so long as we "owe it to ourselves". We are faced with the curious paradox that we ought not to have to borrow at all; for if a debt that we "owe to ourselves" is no burden, then by the same token taxes that we "pay to ourselves" are no burden, and we should be able to dispense with borrowing entirely and finance ourselves entirely on a pay-as-you-go basis. Or, having borrowed, it should be possible, on the theory, to cancel the debt without harm, since we would, after all, only be cancelling it to "ourselves".

Do They Mean What They Say?

Of course no one believes such absurdities. Those who assert or imply that a debt "owed to ourselves" is no burden quite clearly do not mean to be taken too literally. Otherwise, Mr. Eccles would hardly feel called upon to say, as he did in his address of January 23, 1939, "I do not believe, and I have never said, that the federal debt should continue to grow indefinitely and no part of it ever be paid". Nor would the President feel impelled to add to the statement quoted earlier, "A *reasonable* (italics ours) internal debt will not impoverish our children". The question is, what is "reasonable".

Though Prof. Hansen contends at one point that an internally held public debt is so different from an ordinary debt that "it could hardly be called a debt at all", he observes at another point that "nobody knows how great an internal debt a nation could manage—without repudiation or uncontrolled inflation—because the test has never been made".*

*The statement that "the test has never been made" is open to question. The British economist, Lord Keynes — a leading exponent of the managed currency and government spending doctrines — stated in his book, "Monetary Reform," published in 1924, that "in several countries the existing burden of internal debt renders devaluation inevitable and certain sooner or later." Among such countries, Lord Keynes mentioned specifically France.

At still another point he says:

> Safe limits (to the debt) will be determined primarily by the level of the national income. Other governing factors are the kind of taxation levied to service the debt and the manner in which it is distributed among the various types of bondholders — and, of course, the wisdom of the public investment and public expenditures made.

That the above is true not even the most orthodox economist would deny. It is precisely just such considerations that *do* determine how much debt a nation can carry. But acceptance of such qualifications would seem to put the whole argument on an entirely different basis.

Where the Fallacy Lies

It is perfectly true, as Prof. Hansen has indicated, that "the sums collected in taxes to pay interest on the public debt are not, so to speak, thrown into the ocean; instead they are returned at once to the community".

But this is far from telling the whole story. Though *collectively speaking* the payments of taxes do come back to the people in the form of interest, they do not come back to the same people—at least not in the same proportion. And that is where the trouble arises. What from a national standpoint may appear to be no more than a mere bookkeeping balancing of debits and credits of taxpayers and bondholders, becomes for the individual an intensely personal matter of A giving up money in taxes to pay B in interest. Anyone having experience in tax legislation knows what a hornets' nest of controversy that can stir up.

It is just because of this unwillingness of the taxpayer on the one hand to pay tribute in ever-increasing amounts to bondholders on the other that a rapidly rising national debt—even when "owed to ourselves"—is fraught with danger. The individual taxpayer takes little comfort in the fact that in the national accounting the taxes he pays are balanced by the interest some one else receives. All he cares about is that his taxes are going up, and he doesn't like it. In this way political pressures are generated against increasing taxes which, if the debt is too heavy, may force continuous borrowing and thus lead to uncontrolled inflation.

Even if it were true — as it is not — that we could distribute the taxes among bondholders in the same proportion as they hold bonds, it is unlikely that we would want to do so. For in the case of the war debt this would mean, as Prof. Ratchford of Duke University pointed out in the September 1942 American Economic Review, concentrating the tax burden on the very people and institutions (insurance companies, savings banks, etc.) who had supported the bond drives during the war, and exempting those who were either unable or unwilling to subscribe when the nation needed the money. Moreover, it is obvious that any such concentration of taxes on government bondholders would make government bondholding highly unattractive; people would sell, causing prices to fall and government financing costs to rise, to say nothing of other complications.

Debt, Taxes, and Enterprise

Apart from the danger of inflation getting out of control, one of the worst features of a mounting debt burden is the scramble of different groups of taxpayers to shift the taxes to other shoulders. In this struggle for advantage, the contest is almost inevitably resolved in favor of those groups having the most political power. What emerges is a tax system based more upon political expediency than upon sound economic considerations, with constantly rising taxes levied upon the corporations and upper individual incomes which have relatively few votes and are always good political targets.

Taxes levied in this way have the effect of limiting savings and private investment and enterprise. The higher the debt and the greater the interest charges, the stronger these inhibiting forces are likely to be. As long as a rising debt means more and more taxes of the kind that penalize success, it is a serious mistake not to recognize that increasing debt—whether "owed to ourselves" or to some one else—is a burden upon the economy. It is a burden because it discourages incentive and risk-taking, without which the system cannot advance.

That Prof. Hansen, for one, is well aware of these dangers is evident again and again in his writings, and repeatedly he stresses the need for preserving economic incentives. It is all, he contends, a matter of how the taxes are distributed. "Here," he concedes, "is a problem that has got to be solved." But this, as one commentator* has acutely remarked, is not just *a* problem; it is *the* problem. It is, indeed, the crux of the whole question of debt.

Were it possible to conjure up a dream world in which tax-levying is divorced from politics and the pushing and pulling of conflicting social philosophies, with the burdens distributed so wisely and equitably that the incentive to enterprise is maintained, it would be a lot easier not to worry about increasing debt. As it is, we do not live in a dream world, but have to take account of how human beings actually behave. We have to bear in mind that a big national debt sets up debtor-creditor relationships which constitute in effect a redistribution of wealth, with profound influence upon savings, investment, and consumption, and hence upon the rate of economic progress.

* Should a Government Debt, Internally Held, Be Called a Debt at All? by Dr. L. Albert Hahn, in The Banking Law Journal, July 1943.

We have to bear in mind, also, that a rapidly rising debt almost inevitably gets, in one way or another, into the banks, with consequent inflationary expansion of credit. It has posed in all countries the problem of controlling the inflationary forces, leading in turn to increased regimentation and overhead control of the entire economy. Practically speaking, the bigger the debt, the stronger the forces leading towards inflation or a managed economy, or both.

History is replete with examples of countries that have got into trouble as a result of loose fiscal policy and the piling up of more government debt than they could manage.

On "Doing the Job Pays the Bill"

This tendency to minimize the human elements in the problem of distributing government costs appears to be reflected in the following quotations from two pamphlets published by the National Resources Planning Board, which this year was dissolved by Congress:

From "After Defense — What?" (published August 1941):

> When we organize for maximum production on the basis of full employment, without being stopped by costs, we discover, as have other nations, that increased production pays the real costs involved. Doing the job pays the bill. In other words, the central problem is not money, it is man-power, resources, and organization. At last we are beginning to see that finance was made for man, and not man for finance.

From "After the War — Full Employment" (January 1942):

> The notion that we cannot finance our own production is quite without foundation. Every cent expended, private and public, becomes income for members of our own society. Costs and income are just opposite sides of the same shield. We can afford as high a standard of living as we are able to produce.

The statement in the above that we need not worry about costs, that "doing the job pays the bill," may have sounded convincing to some people in August 1941, but what of it today in the face of our enormous budgetary deficits? Apparently the explanation intended is that indicated in the second quotation: that when money is expended — for whatever purpose, whether public or private — it places income in the hands of the people; and since this income must necessarily equal the cost, then everything must be all right.

Now it is of course true that incomes and costs do balance in this sense. But the flaw in the argument so far as public expenditures are concerned is that income in the hands of the public and income to the Treasury are not the same thing. There is the old troublesome question of who pays the taxes. Dr. Harold Moulton, president of the Brookings Institution, makes this point clear in his recent book, "The New Philosophy of the Public Debt," in discussing the National Resources Planning Board's proposition that "costs and income are just opposite sides of the same shield." He says:

> The initial error in this proposition is that costs and income are *not* opposite sides of the *same* shield. The *costs* are costs to the Treasury; the *income* is income to the public. And the Treasury cannot get back all of its outlays in the form of taxes. Hence there is no identity between outflow and inflow. The Treasury goes into debt.

While the Resources Planning Board is right in emphasizing the problem of manpower, resources, and organization in production, it is wrong to underrate the importance of money in a money economy. People have to be paid in money; which means that, when the Government spends, taxes have to be raised, and so it comes back again to the question of who is going to pay the taxes.

The assertion that "at last we are beginning to see that finance was made for man, and not man for finance" has a certain rhetorical flourish; but one might as logically attempt to dismiss the dangers of improper handling of matches by saying that matches were made for man, and not man for matches.

Public vs. Private Debt

These considerations applying to government spending and debt suggest important differences in the effects of public and private debt expansion that are not always well understood. The question is sometimes asked why, if the creation of public debt increases the supply of goods and facilities that have real value and adds to the national income, it is any less desirable than the creation of private debt for like purposes. Of similar character basically was the argument advanced several years ago by advocates of the spending philosophy that because the rise of public debt since 1929 had been about offset by the decline of private debt, there was nothing to worry about.

In comment on this line of reasoning, it should be said, first, that expansion of *either* public or private debt is bad if it is too rapid or if the money is spent wastefully.

There are, however, two principal differences in the nature of public and private debt that need emphasis in making comparisons and determining policy:

1. In the case of private debt there is never any question about who is to pay the interest. Interest on private debt is a burden assumed voluntarily by the debtor, usually in expectation of employing the money at a profit. The interest the debtor pays is thus associated directly with a benefit received or anticipated and—in the nature of the case—is distributed automatically more or less in proportion to capacity to pay. All this makes a great difference in the debtor's willingness, and in most cases in his ability, to pay.

In the case of public debt, on the other hand, there is always controversy as to who is to

pay the taxes. Taxes on public debt, unlike interest on private debt, are thrust upon the taxpayer without his individual consent. The taxes he pays are for the purpose of paying for government expenditures for which he has no comparable sense of responsibility or conciousness of benefits received. Instead of taxes being adjusted automatically in accordance with benefits received and capacity to pay, as in the case of interest, the whole thing is political. The result is resentment, opposition, and contention—in other words, the same old problem again of who is going to shoulder the burden, which is at the root of so much of the difficulty in questions of public finance.

2. Expansion of private debt is more likely to be for purposes that increase the productive facilities of the country than expansion of public debt. War and preparations for war—the chief cause for creation of national debts—are of course entirely non-productive and even destructive in an economic sense. But apart from this, government debt tends to be less productive than private debt: first, because political pressures tend to promote wastefulness in government spending; and, second, because government expenditures—unless they encroach upon private enterprise—are more likely to be for "social" purposes which, desirable though they may be in themselves, are not usually "productive" in the sense of creating a continuing source of income out of which the debt can be serviced. Some government expenditures, to be sure, for roads, harbors, etc., when wisely made, do increase the national productive capacity; but even in these cases construction and maintenance are usually dependent upon general tax revenues and hence raise a tax problem.

These contrasting characteristics of the two types of debt afford an answer to the question posed above, why creation of public debt is less desirable than creation of private debt. Likewise they indicate the fallacy of regarding a decline in private debt as an "offset" to a rise of public debt. In a system of private capitalism this substitution of public for private debt is in itself an extremely disquieting sign. Failure to recognize these fundamental distinctions in formulating public policies can be disastrous.

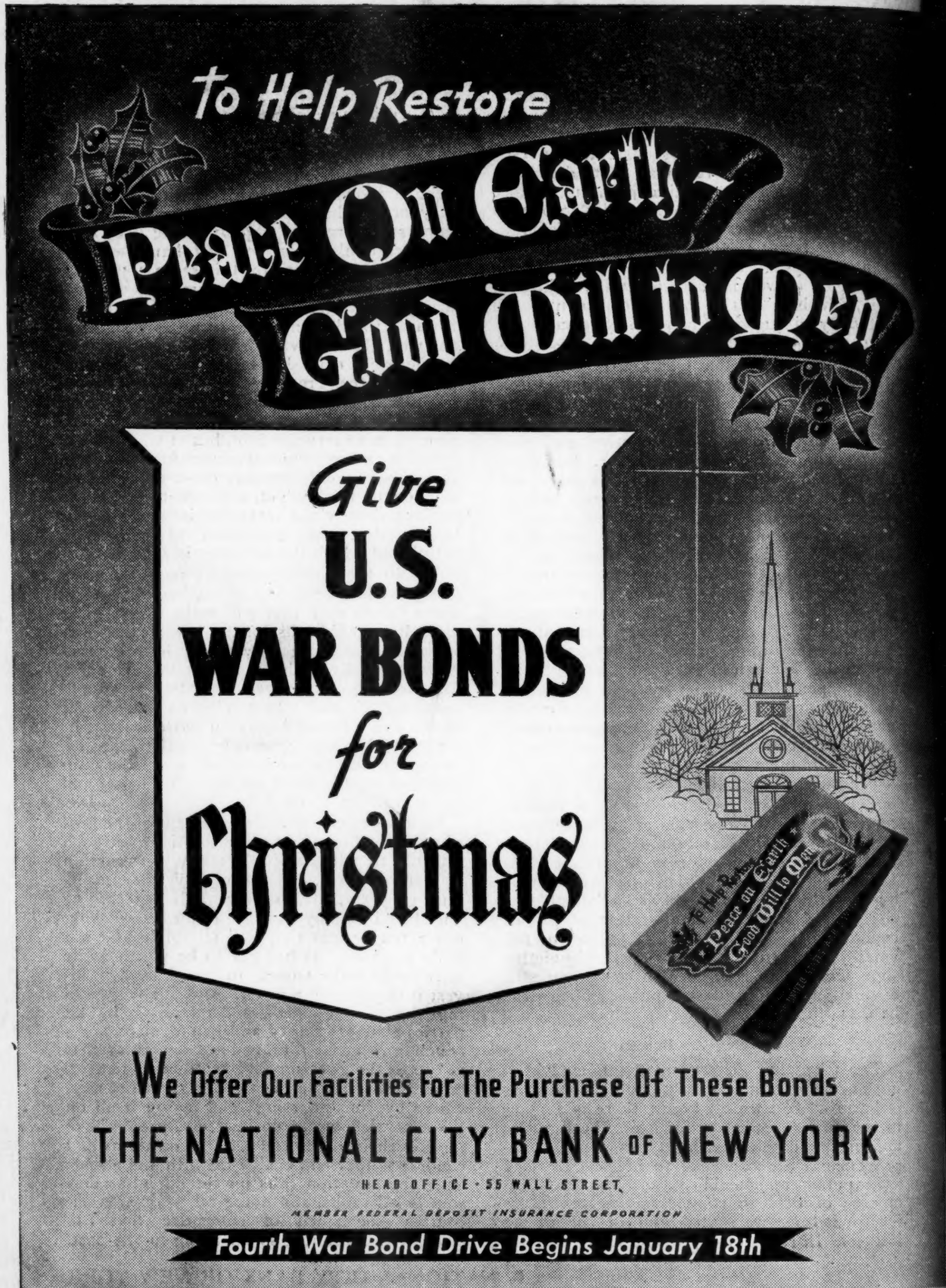
Carrying the Burden

The foregoing discussion of public debt is not of course to imply that all public borrowing is harmful. As we all know, there is a place in the modern economy for use of both public and private credit. Certain types of public improvements are conceded to be best handled as a public responsibility, and moderate increases of debt in connection therewith are recognized as warranted and in the public interest. In times of depression it is generally agreed that a rigid balancing of the budget is impracticable, and that government expenditures in excess of tax receipts can be helpful as a cushioning element to alleviate distress and give time for necessary readjustments.

The question is in large measure a relative one, in that while moderate increases of public debt in proportion to real wealth and income may not be harmful and may serve a useful purpose, a large and rapidly rising debt is almost certainly a burden and handicap; and public apprehensions on this score appear entirely justified. At the same time this does not mean that we should take a defeatest attitude towards the debt now piling up as a result of the war. The growth of this debt has been an unavoidable evil. Its existence will, as suggested in the Treasury memorandum quoted at the outset of this article, make more difficult the problem of post-war readjustment. The country can carry the debt, but at what cost in inflation and regimentation remains to be seen. It depends upon how many other expenses we load on to the budget, and whether we can achieve, despite the retarding influence of the tax burden, the expansion of productive activity of which the economy is capable.

To do the latter, however, requires many things. It requires, first of all, avoiding doing those things now that will make things more difficult later. It calls for hard work, and saving and elimination of waste by both government and individuals. It means, in our financing program, avoidance of inflationary expension of bank credit by paying as much taxes as we can without injury to morale and efficiency, and by selling more bonds to the people. It means forbearance by all groups from policies that tend to drive up prices and costs and get everything up on stilts.

On the positive side, achievement of the goal requires finding practicable solutions for such difficult transitional problems as termination of war contracts, disposal of government surplus property, etc., so that industry can go ahead and employ people. It means working out a tax system that will stimulate and not stifle incentive. It has got to be worth while striving to make money, to save it, and to invest it in hopes of a profit. And finally, reaching the goal requires understanding by all parties that prosperity and employment are a common responsibility, and not something that is "up to the government", or to management, or any other single group. We can't get anywhere by "buck-passing" and laying it all on the other fellow; to do business, people have to offer their goods and services on terms and conditions that will enable them to find a market. The situation calls for intelligent leadership in all ranks, and doing all we can to encourage the spirit of enterprise that has brought this country so far along in the past.



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